No. 11,547

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

RAINIER BREWING COMPANY, a Corporation,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF FOR RESPONDENT.

A. CALDER MACKAY,
ARTHUR MCGREGOR,
HOWARD W. REYNOLDS,
ADAM Y. BENNION,
728 Pacific Mutual Building, Los Angeles 14,
Attorneys for Respondent.

Of Counsel:
F. SANFORD SMITH,
CLIFFORD J. MACMILLAN.

FILED
SEP - 4 1947
PAUL P. O'BRIEN,
CLERK

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

TOPICAL INDEX

PAGE

Opinion below 1

Jurisdiction 1

Questions presented 2

Statement of the case 3

First issue 3

Second issue 8

Summary of argument 9

First issue 9

Second issue 11

Argument 13

First issue 13

Introductory 13

I.

The Tax Court, in the Seattle case as in the Rainer case, held that the transaction was a sale and not a license, that the million dollars constituted purchase price and not advance royalty 16

II.

The Tax Court was correct in finding and deciding that the transaction constituted a sale rather than a license 24

III.

Reply to the Commissioner's argument on brief 34

Second issue 53

Conclusion 62

TABLE OF AUTHORITIES CITED

Cases. PAGE

American Box Shook Exp. Assn. v. Commissioner, 156 F. (2d) 629 ....8, 40

American Crayon Co. v. Prang Co., 38 F. (2d) 448....10, 43

Andrew Jergens Co. v. Woodbury, Inc., 273 Fed. 952....29, 48

Armstrong Paint & Varnish Works v. Nu-Enamel Corp., 305 U. S. 315, 83 L. Ed. 195.... 45

Beckwith, P. D., Estate of, v. Comm. of Patents, 252 U. S. 538, 64 L. Ed. 705.... 45

Belknap v. United States, 55 F. Supp. 90.... 58

Burnet v. Harmel, 287 U. S. 103.... 24

Burnet v. Thompson Oil & Gas Co., 283 U. S. 301, 75 L. Ed. 1049 61

Canadian Club Beverage Co. v. Canadian Club Corp., 168 N. E. 106 ....t....10, 32, 43

Choate v. Commissioner, 324 U. S. 1, 89 L. Ed. 653....11, 38, 39, 40

Clarke v. Haberle Crystal Springs Brewing Company, 280 U. S. 384, 74 L. Ed. 498.... 53

Coca-Cola Bottling Co. v. Coca-Cola Co., 269 Fed. 796........10, 30, 43, 44, 47

Delaware and Hudson Canal Co. v. Clark, 13 Wall. 311, 20 L. Ed. 581 11

Delaware and Hudson Canal Co. v. Clark, 13 Wall. 311, 20 L. Ed. 581 48

Dobson v. Commissioner, 320 U. S. 489, 88 L. Ed. 248; rehear. den. 321 U. S. 231, 88 L. Ed. 691....11, 14, 35, 36, 37, 38, 41, 61

Esso, Inc. v. Standard Oil Co., 98 F. (2d) 1....10, 42

Fairbanks v. United States, 306 U. S. 436.... 24

Goldsmith v. Commissioner, 143 F. (2d) 466; cert. den. 323 U. S. 774.... 50

Griggs, Cooper & Co. v. Erie Preserving Co., 131 Fed. 359....28, 47

PAGE

Hale v. Helvering, 85 F. (2d) 819 .... 24, 47

Hall v. United States, 43 F. Supp. 130; cert. den. 316 U. S. 664 59

Hanover Star Milling Co. v. Metcalf, 240 U. S. 403, 63 L. Ed. 713 .... 10, 42

Helvering v. Elbe Oil Land Development Co., 303 U. S. 372, 82 L. Ed. 904 34

Helvering v. Flaccus Leather Co., 313 U. S. 247 24

Helvering v. Owens, 305 U. S. 468, 83 L. Ed. 292 60

Hogan v. Commissioner, 141 F. (2d) 92 39

John v. Dobson, 46 B. T. A. 770 36

Landsberger v. McLaughlin, 26 F. (2d) 77 57

Motlow v. Oldetyme Distillers, Inc., 88 F. (2d) 732 46

Old Colony Trust Co. v. White, 34 F. (2d) 448 59

Oppenheim, E. Phillips, 31 B. T. A. 563 49

Parke, Davis & Co., 31 B. T. A. 427 .... 22, 44, 52

Pennsylvania Petroleum Co. v. Pennzoil Co., 80 F. (2d) 67 45

Ph. Schneider Brewing Co. v. Century Distilling Co., 107 F. (2d) 699 .... 46, 52

Red Wing Malting Co. v. Willcuts, 15 F. (2d) 626; cert. den. 273 U. S. 763 57

Scales, H. L., 10 B. T. A. 1024 26

Schiller, Avery R., 43 B. T. A. 594 37

Seattle Brewing & Malting Company v. Commissioner, 6 T. C. 856 .... 3, 4, 14, 16, 17, 18, 20, 23, 35

United Drug Co. v. Rectanus Co., 248 U. S. 90, 63 L. Ed. 141 .... 10, 42, 45

United States v. Ludey, 273 U. S. 295, 71 L. Ed. 1054 61

Virginian Hotel Co. v. Helvering, 319 U. S. 523, 87 L. Ed. 1561 .... 57, 58

Waterman v. Mackenzie, 138 U. S. 252 51

Yost v. Commissioner, 155 F. (2d) 121 46

Miscellaneous

PAGE

Cumulative Bulletin VII-2, p. 35 27
Cumulative Bulletin XII-2, pp. 131, 134, I. T. 2735 49
General Counsel Memorandum 23162, Cum. Bull. 1942-1, p. 106 27
House Report 1882, 70th Cong., 1st Sess., pp. 11-12 59

Statutes

Internal Revenue Code, Sec. 23(1) 59
Internal Revenue Code, Sec. 113(b)(1)(A) 12, 61
Internal Revenue Code, Sec. 113(b)(1)(B) 12, 53, 61
Internal Revenue Code, Sec. 272 1
Internal Revenue Code, Sec. 1141 2
Internal Revenue Code, Sec. 1142 2
Revenue Act of 1928 59

No. 11,547

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

RAINIER BREWING COMPANY, a Corporation,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF FOR RESPONDENT.

Opinion Below.

The Findings of Fact and Opinion of The Tax Court [R. 37-78] are reported at 7 T. C. 162.

Jurisdiction.

On March 9, 1944, the petitioner, Commissioner of Internal Revenue (hereinafter referred to as the Commissioner), mailed to the respondent (hereinafter referred to as Rainier or the taxpayer) a notice of deficiency proposing deficiencies in income tax, declared value excess profits tax, and excess profits tax for the calendar year 1940 aggregating $539,888.12 and a deficiency in excess profits tax for the calendar year 1941 in the sum of $26,119.92. [R. 16-30.] On May 12, 1944, pursuant to Section 272 of the Internal Revenue Code and within the 90-day period prescribed by that Section, Rainier

filed with The Tax Court its petition for redetermination of said deficiencies. [R. 5-30.] The petition was heard on July 19-21, 1945, and The Tax Court entered its decision on August 12, 1946. [R. 78-9.] The Commissioner filed his petition for review on November 5, 1946, and served notices and copies thereof on November 8 and 12, 1946, pursuant to Section 1142 of the Internal Revenue Code. [R. 79-86.] The jurisdiction of this Court rests upon Section 1141 of the Code.

Questions Presented.

1. Whether there is warrant in the record for The Tax Court's finding of fact that a sale of a capital asset took place in 1940 when Seattle Brewing & Malting Company delivered to Rainier $1,000,000.00 in promissory notes in consideration for the grant of the sole and exclusive perpetual right and license to manufacture and sell beer, ale and other alcoholic malt beverages under the trade name "Rainier"* in the State of Washington and Territory of Alaska; and whether The Tax Court employed correct legal principles in concluding that this transaction constituted a sale rather than a mere license.

2. Whether The Tax Court was correct in determining from the record that the March 1, 1913 value of Rainier's trade name and good will in Washington and Alaska should be reduced only by the sum of $138,137.40 as a result of the erroneous allowance of obsolescence.

---

*The transaction also involved the name "Tacoma," but this name was insignificant, was not used by the Seattle Company [R. 13 and 33] and will be disregarded in this brief. See the footnote in the Commissioner's brief, page 6.

STATEMENT OF THE CASE.

First Issue.

The statement regarding the first issue on pages 3 to 19 of the Commissioner's brief is taken largely from The Tax Court's findings of fact and is accepted by Rainier as a correct recital with the following exceptions:

1. The reference on page 14, to the amendment dated November 27, 1935, and the paragraph quoted therefrom do not appear in The Tax Court's findings. The amendment purports to grant a special right to Rainier to sell "Rainier Special Export" beer to the Alaska Commercial Company—sales which Rainer agreed to discontinue within 10 days after demand by Seattle. The amendment further provided that Rainier would pay over and account to Seattle for the net profit resulting from such sales; that Rainier had actually made such sales from July 1, 1935, the effective date of the contract, to November 27, 1935, the date of the amendment, and that Rainier would turn over to Seattle the net profit resulting therefrom and Seattle would waive any violation of the agreement of July 1, 1935, resulting from such sales. [R. 690-691.] Hence this amendment was a confirmation, and not a derogation, of Seattle's rights under the agreement of April 23, 1935.

2. At the conclusion of the Commissioner's statement on this issue (Br. 18-19) reference is made to The Tax Court's finding that the transaction constituted the sale and acquisition of a capital asset, and it is stated that The Tax Court relied upon its decision in No. 11,467, *Seattle Brewing & Malting Company v. Commissioner*, 6 T. C. 856. We do not agree with the Commissioner's statement that The Tax Court *erroneously assumed* that

since the transaction had been held to be the acquisition of a capital asset in the *Seattle* case it necessarily followed that Rainier had sold a capital asset. As we shall show hereinafter, *The Tax Court made no such assumption* at all, but in fact held, not only in this case but equally in the *Seattle* case, that insofar as both parties to the contract were concerned the transaction constituted a sale rather than a license and the consideration in question represented selling price rather than prepayment of royalties.

3. Bearing upon the intent of the parties as to whether the forfeiture provisions of the agreement would be effective *after* the exercise of the option, the following facts are significant:

On July 18, 1935, less than three months after the agreement was executed, the parties entered into a supplemental agreement [Ex. 3, R. 632-645] which recites "that in order to more fully and correctly set forth the intention and understanding of the parties" [R. 637], paragraph Twelfth of the agreement was amended to read as follows:

> "It is the purpose, understanding and intention of the parties hereto that at all times and as long as this Agreement remains in force, the said real property [the Seattle plant], or the proceeds realized upon the sale thereof (to the extent of not to exceed Two Hundred Fifty Thousand Dollars ($250,000.00) or cash, lawful money of the United States equal and equivalent to the fair value of the property and improvements at the time of loss (not to exceed, however, the sum of Two Hundred Fifty Thousand Dollars ($250,000.00) shall stand as security for the prompt and faithful performance by Century

of all of its obligations under this Agreement, and in the event of default, be transferred and delivered to Rainier as and for liquidated damages." [R. 640.]

The next day, July 19, 1935, in order to carry out this intention, a trust indenture was executed [Ex. 6, R. 656-685], which recited that it was executed to carry out the provisions of the contract of April 23, 1935, and that Rainier would not have executed that contract unless Century had agreed to pledge the plant as security "for the prompt and faithful performance * * * of all of the terms and provisions contained in said Agreement * * *." [R. 659-660.] Article V of the trust indenture provided in part as follows [R. 672-673]:

> "*Section 1.* If the Grantor [Century] shall well and truly perform and observe each and all of the covenants, agreements and conditions of said Agreement, dated April 23, 1935, * * * or if the Grantor shall avail itself of the option expressed in paragraph THIRTEENTH of said Agreement dated April 23, 1935, and shall cause the payment to the Beneficiary in cash of the sum therein provided to be paid in the event of the exercise of such option, then and in that case, the estate, right, title and interest of the Trustee hereunder shall cease and determine and the property, premises, rights and interests hereby conveyed shall revert to the Grantor * * *."

Upon payment of the last of the five notes the trust was terminated and the Seattle plant was released to the Seattle Company. [R. 709.] There was thus ended, in accordance with the terms of the trust executed on July 19, 1935, the possibility of liquidated damages being forfeited under paragraph Twenty-Second, quoted on pages 12 and 13 of the Commissioner's brief.

4. Bearing upon the intention of the parties at or about the time the option was exercised in 1940, before any controversies arose as to the effect of the contract for tax purposes, the following facts are significant:

In the official "Annual Statement" of Rainier Brewing Company to its stockholders for the year ended December 31, 1940, dated prior to April 18, 1941, signed by Mr. Joseph Goldie, President, the following report was made:

> "There were received during 1940 five installment notes of $200,000.00 each, maturing July 1, 1941, 1942, 1943, 1944, and 1945. * * * The total of the notes, namely $1,000,000.00, was received in consideration of the sale of certain intangible assets * * *." [Ex. 34, R. 808-14, and particularly R. 810.]

A formal prepared statement was issued on April 11, 1940, by Mr. Emil G. Sick, President of the Seattle Company, which was quoted verbatim on April 12, 1940, in the Business and Finance Section of the Seattle Post-Intelligencer in an article by the Financial Editor of that newspaper. [Ex. 39, R. 826.] The statement issued by Mr. Sick, shortly before the exercise of the option, was as follows:

> "In April of 1935 the Century Brewing Company purchased the old Rainier plant at Georgetown and likewise took over the business of the Rainier Brewing Company of San Francisco in the State of Washington and Alaska.
>
> "* * * A contract was made with the Rainier Brewing Company of San Francisco to pay Rainier

a minimum of $75,000 a year and a certain extra amount on barrelage of over 100,000.

"This payment was to extend for five years and currently run around $100,000 a year. *Under the contract the Seattle Brewing and Malting Company is now privileged at the end of the fifth year to make outright purchase for one million dollars.*" (Emphasis added.)

The article stated that a special meeting of Seattle's stockholders would be held in the next two weeks "to exercise the company's option on the purchase of all rights connected with its manufacture and distribution of Rainier beer"; the company was entertaining alternative plans, either to make "an outright cash purchase for one million dollars (the amount it would cost to exercise the option)" or to give Rainier five notes for $200,000.00 each; and the financing plans to carry out the deal contemplate issuance of new stock to Seattle's shareholders on terms described by Mr. Sick as very reasonable.

The identical article, quoting Mr. Sick's statement verbatim, also appeared in the trade magazine "Brewer and Dispenser." [Ex. 40, R. 827.]

Other relevant evidence included two reports by Dun & Bradstreet, one dated August 26, 1940, covering Rainier Brewing Company [Ex. 35, R. 815-19] containing the following statement [R. 818]:

"* * * An additional favorable development has been the exercising by Seattle Brewing & Malting Co. of its *option to purchase outright* the rights to

use the name of Rainier in the Pacific Northwest * * *." (Emphasis added.)

The other, dated August 14, 1941, covering Seattle Brewing & Malting Company [Ex. 36, R. 820-24], included the following statements [R. 823]:

> "* * * At the same time [in 1940], rights to use of the formula and brand name of 'Rainier' beer in Washington and Alaska previously utilized on a royalty basis, *were purchased* for $1,000,000, paying part cash with the balance due in five years. Additional capital stock was sold, with the proceeds of $600,292.50 in par and premiums being used to finance a portion of the purchase of the 'Rainier' rights and the rest added to working funds." (Emphasis added.)

Second Issue.

The Commissioner's statement of facts on the second issue is taken from The Tax Court's findings. The stipulation upon which these findings were based showed that obsolescence was claimed for the year 1919 only in the sum of $174,188.84. [R. 126-7.] No other obsolescence was ever claimed by the taxpayer. The Tax Court found, as part of its opinion [R. 72], that obsolescence had not been allowed beyond the extent determined by it ($138,137.40). See *American Box Shook Exp. Assn. v. Commissioner,* 9 Cir., 156 F. (2d) 629, 631, to the effect that the findings may be read together with the opinion to ascertain what The Tax Court found as facts.

SUMMARY OF ARGUMENT.

First Issue.

The two contracting parties expressed their intent and understanding, both in 1935 and when the option was exercised in 1940, that exercise of the option and payment of the million dollars would constitute a *purchase* by Seattle and a *sale* by Rainier of the trade name "Rainier" for use in connection with beer, ale and other alcoholic malt beverages in Washington and Alaska. This expression of intent on the part of the Seattle Company in 1940 took the form of a public announcement by its president of a proposed issuance and sale of new stock in order to finance "the purchase."

The property in a trade name consists of the right to use it only in the market where that name has become associated with a product, coupled with the corresponding duty on the part of others not to use the same name on the same or similar goods in the same area, to the confusion of the public and detriment of the owner of the name. The property in a name grows out of its use, and the right of user remains at all times the fundamental property interest in the name. It exists as property only in connection with a going business and hence only in the areas where that business is conducted. In other words, the property in a name is definitely linked to geography, for beyond the localities where it has achieved significance in a business it does not exist. In these two aspects—use and geographical limitation—a trade name is basically different from either a copyright or a patent, the issuance of which grants to the owner immediate and nation-wide property rights that continue to be owned whether actively exploited or withheld from use.

The same trade name used on the same goods may be owned at the same time by two different companies operating in different geographcial areas. *United Drug Co. v. Rectanus Co.,* 248 U. S. 90, 63 L. Ed. 141; *Hanover Star Milling Co. v. Metcalf,* 240 U. S. 403, 63 L. Ed. 713; *Esso, Inc. v. Standard Oil Co.,* 8 Cir., 98 F. (2d) 1, 7. Hence, there is no reason why, as a matter of law, the owner of a name used in a business cannot sell the name along with the business in a given locality, while retaining its business elsewhere. Similarly, the ownership of a trade name may be granted to another for use in the sale of certain products or in carrying on a distinct phase of a business, while the name is retained for use in connection with other products or another phase of the business. *American Crayon Co. v. Prang Co.,* 3 Cir., 38 F. (2d) 448; *Coca-Cola Bottling Co. v. Coca-Cola Co.,* D. C. Del., 269 Fed. 796; *Canadian Club Beverage Co. v. Canadian Club Corp.,* S. C. Mass., 168 N. E. 106.

When a company withdraws from business in a given territory and receives $1,000,000.00 for the perpetual and exclusive right to the use of its name by another company, which thereafter carries on the business from which the first company withdrew, such a transaction as a practical matter and as the term is commonly understood is a sale or tantamount to a sale of the business, its good will and the name that symbolizes the good will. It was so regarded and characterized by both parties to the contract in the instant cases long before any dispute arose regarding tax consequences. It is immaterial whether the business that is transferred consists of manufacturing or merely selling and marketing. Furthermore, a sole, perpetual and exclusive right to use a trade name is treated, as a matter of law, as an assignment of the

property in the name—this for the reason that the "right to use" is practically identical with "property" in a name. Such identity is reflected in the phrase used by the Supreme Court in *Delaware and Hudson Canal Co. v. Clark,* 13 Wall. 311, 20 L. Ed. 581, 583:

> "* * * Property in a trademark, or rather in the use of a trademark or a name, * * *."

Particularly is such a transaction equivalent to a sale in the practical field of taxation, for the assignor has conveyed *permanently* the entire beneficial interest in the name, and unless permitted to recoup his capital investment out of the lump-sum consideration he will lose it forever. The beneficial ownership and economic gain to be derived from the name in the given locality are gone. Refinements of title and legal niceties cannot obscure the reality of transfer of the practical benefits and risks of ownership.

Hence, The Tax Court was correct, both factually and legally, in construing the transaction as a sale rather than a mere license. Moreover, its findings and conclusions have warrant in the record and accordingly may not be disturbed. *Dobson v. Commissioner,* 320 U. S. 489, 88 L. Ed. 248, rehearing denied, 321 U. S. 231, 88 L. Ed. 691; *Choate v. Commissioner,* 324 U. S. 1, 89 L. Ed. 653.

Second Issue.

Obsolescence of good will was not "allowable" as a result of the adoption of national prohibition in 1920. Such obsolescence was claimed as a deduction by Rainier for 1919 in the sum of $174,188.84. No other amount of obsolescence was ever claimed by Rainier. The Com-

missioner allowed $59,153.48 as a deduction for obsolescence in 1919, and to this extent the taxpayer's basis must be reduced under Section 113(b)(1)(B) of the Code. The Commissioner then determined that the great bulk of the good will loss, as computed by him ($345,-061.95), was "allocable" to 1918. The taxpayer had not claimed that amount as a deduction for obsolescence for 1918 or for any other year. Its return for 1918 showed a net loss wtihout any deduction for obsolescence. The Tax Court was obviously correct in determining that the gratuitous unilateral determination or allocation of an amount by the Commissioner does not constitute the "allowance" of a deduction where it has never been claimed by the taxpayer. The Commissioner may not by his own action thus penalize a taxpayer; and on a subsequent sale of the property the taxpayer is entitled to recover its basis undiminished by such an "allocation" on his part. Rainier, however, seeks no unfair tax advantage and therefore concedes here, as it did below, that account should be taken of the benefit that accrued to it as a result of a combination of the Commissioner's allocation to 1918 and his recalculation of Rainier's income for that year, to show a net income of $78,983.92 instead of a net loss. The Tax Court's conclusion on this issue has warrant in the record and embodies principles of tax accounting substantially identical with those involved in the *Dobson* case itself. The Tax Court's determination of what constituted a proper adjustment of basis under Section 113(b)(1)(A) of the Code was held to be conclusive in the *Dobson* case. The same principle applies here to its determination of the proper adjustment of basis under Section 113(b)(1)(B).

ARGUMENT.

First Issue.

INTRODUCTORY.

On the American scene a right to sell goods under an established trade name may be a property right of great value. This was true of the right to sell beer under the name "Rainier" in Washington and Alaska at March 1, 1913, for The Tax Court valued the right at $514,-142.00. The Commissioner does not challenge that finding, and the Internal Revenue Code ordains that the value of property on that date shall, for tax purposes, be deemed to be its basis, just as if cash in that amount had been put out to acquire the asset.

And the right to sell beer under the name "Rainier" in Washington and Alaska was likewise valuable in 1940, as evidenced by the willingness of Seattle Brewing & Malting Co. to pay Rainier $1,000,000.00 in notes for the exclusive and perpetual exercise of such right.

Rainier, of course, has paid income tax upon the gain it admittedly realized on the transaction, measured by the difference between the million dollars received and the basis of the property adjusted in accordance with The Tax Court's decision. The Commissioner, however, would calculate Rainier's 1940 tax by disregarding its basis of $514,142.00 and subject every penny of the million dollars not only to normal tax and surtax but to the high war-time excess profits tax. Thus, on a transaction resulting in gain to Rainier of $623,995.40 as determined by The Tax Court, the Commissioner seeks to collect from it a tax of $539,888.12, or 86.52% of the gain.

The theory upon which such an exhorbitant tax is said to be justified is that Rainier did not sell anything; and a taxpayer can take account of its cost or other basis only in the event of a sale or exchange. At the same time the Commissioner insists that Seattle cannot deduct the million dollars because it was a capital outlay—the purchase price of a capital asset.

In Part A of his brief (pp. 25-30) the Commissioner attempts to justify this inconsistent result by saying that the million dollars *could constitute* "an advance lump sum royalty" taxable as ordinary income to Rainier, even though to Seattle the payment would represent the non-deductible purchase price of a *license having an indefinite life.* Part B of his brief (pp. 30-37) attempts to avoid the *Dobson* doctrine by creating the impression that The Tax Court fell unwittingly into error in deciding the *Rainier* case solely on the authority of its decision in the *Seattle* case. The *Seattle* case, according to the Commissioner's present argument, did not decide whether the transaction was a sale as opposed to a mere license, but it really intended to hold only that Seattle had acquired a license with an indefinite life; hence, in finding that the transaction amounted to a sale in the *Rainier* case, The Tax Court failed to recognize that the lump-sum royalty, although non-deductible, could be taxed as ordinary income to Rainier.

The Commissioner states that The Tax Court did not have a clear understanding of the effect of its decision in the *Seattle* case (Br. 31); and he goes so far as to say that The Tax Court in that case "was not required to and did not specifically hold that there was a sale." (Br. 32.) He also alleges that a "sale" to The Tax Court

meant only the acquisition of a capital asset (*i. e.,* an indefinite license) by Seattle. (Br. 33.)

The fact of the matter is that The Tax Court *in the Seattle case* expressly held that exercise of the option effected a sale; it expressly held that the transaction *was not a license* after exercise of the option; it expressly held that the payment did not constitute a royalty or an advance royalty; it expressly held that the payment represented not only purchase price to Seattle but selling price to Rainier; and, in reliance upon authorities cited in the Commissioner's own brief—authorities which the Commissioner now seeks to brush aside as distinguishable (Br. 61)—The Tax Court expressly held that the grant for a lump-sum consideration of a perpetual, exclusive license to use a trade name is tantamount to a sale of the property in the name.

The Commissioner perhaps is not to be criticized for taking inconsistent positions in discharging his duty to protect the public revenue; but it appears unusual, at least, for him to argue successfully in a lower court that decided precedents mean one thing, and then, before an Appellate Court reviewing the same transaction, to contend that they do not support the proposition for which he cited them below.

In view of the Commissioner's argument we shall present this brief in the following form: (1) an analysis of The Tax Court's actual holdings in both cases; (2) citations and argument showing the correctness of the Court's holdings; and (3) a reply to the Commissioner's other arguments on brief.

I.

The Tax Court, in the Seattle Case as in the Rainier Case, Held That the Transaction Was a Sale and Not a License, That the Million Dollars Constituted Purchase Price and Not Advance Royalty.

Bearing on the Commissioner's argument that The Tax Court failed to distinguish between the issue in the *Rainier* case and its actual decision in the *Seattle* case, the following facts are significant:

The *Seattle* case was heard by Judge Arthur J. Mellott at Seattle, Washington, on October 31, 1944. [R. 79 in No. 11,467.] Briefs were thereafter filed, including an *amicus curiae* brief by Rainier setting forth its contention that exercise of the option effected a sale of property. [See R. 141 and 147 in No. 11,547.]

The *Rainier* case came on for hearing in San Francisco, California, before Judge Marion J. Harron, and the trial consumed three days beginning July 19, 1945. The interconnection between both cases was brought out in the opening statements by counsel for both parties and was thoroughly discussed throughout the hearing. Upon questioning by the Court at the conclusion of the trial, Mr. Neblett, who tried both cases in behalf of the Commissioner, made the following statements [R. 588-9 in No. 11,547]:

> "The Court: Now, what do you think they did when they exercised this option?
>
> Mr. Neblett: Well, we have taken two positions in it. We say in the Seattle case, your Honor, that they purchased the trade name, and it was a capital transaction. That was the position we took before Judge Mellot.
>
> * * * * * * * *

The Court: Well, now what position do you take in this case?

Mr. Neblett: We take the position in this case that in view of the rights that were reserved that this did not constitute a sale or a capital transaction, it constituted a mere license. In other words, we take an opposite position from what we took in the Seattle case."

Briefs were subsequently filed, including an *amicus curiae* brief by the Seattle Company presenting its interpretation of the contract; and in the meantime, before the *Seattle* case had been decided, Judge Mellott resigned from The Tax Court and the *Seattle* case was transferred to Judge Harron, who, as we have just said, heard the *Rainier* case. Soon thereafter (on April 29, 1946) Judge Harron promulgated the opinion in the *Seattle* case, followed in less than two months by the opinion in the *Rainier* case. [R. 72 in No. 11,467; R. 78 in No. 11,547.] In these circumstances it was only natural that the second case would be decided on the authority of the first, without repeating all that had been said in the earlier lengthy opinion.

In the *Seattle* case the Commissioner argued that the transaction was a sale and not a license.* In his Opening Statement before The Tax Court in the *Seattle* case

*We do not intend to infer that this was his only argument; but his other arguments were advanced for the first time at the trial, as alternatives and "irrespective of whether this was a sale of a capital asset." [R. 88-89 in No. 11,467.]

counsel for the Commissioner stated [R. 91 in No. 11,-467]:

> "And the five year period, the evidence will show, your Honor, was merely a trial period. The Rainier Brewing Company, or the Seattle Brewing Company, formerly the Century Brewing Company, did not want to assume the risk of ownership during that period, so they thought they would see how the royalties would function before they made up their minds to assume the risk of ownership. Therefore the five year clause in the contract."

In his brief filed with The Tax Court in the *Seattle* case the Commissioner made the following statements:

> "* * * The option provision * * * accorded petitioner the right to 'terminate all royalties thereafter payable' under the contract. This it did by execution of the notes aggregating $1,000,000.00. Neither that aggregate obligation nor the several installment notes constitute 'royalties,' because the exercise of the option definitely terminated all royalties; * * *
>
> * * * To say that petitioner acquired no 'title' under the contract is, in effect, to say that title may not be acquired to intangibles. Petitioner's contention that it acquired no 'equity' in the intangibles for its investment of $1,000,000.00 is so unreal and contrary to the evidentiary facts that extended discussion of the point would seem to be unnecessary. Does a binding contract for exclusive perpetual use of designated property rights which are recognized by

the law give an 'equity' in the property or rights? Obviously, the correct answer is in the affirmative.

* * * Upon conversion of the contract to the fixed payment of $1,000,000.00 required under the option, *petitioner acquired more than the permissive use of such assets.* Clearly, it acquired 'title' to the contract not to compete and also title to the goodwill attaching to the various properties acquired from Rainier. * * *

* * * * * * * *

The Court in *Andrew Jergens Co. v. Woodbury* (D. Ct., D. Del., 1921), 273 Fed. 952, *aff'd.* 279 Fed. 1016, *cert. den.* 260 U. S. 728, held that where the owner of a trade-mark gave an exclusive license, with certain exceptions, but the transaction disclosed a purpose to transfer the rights therein, *it was not a mere license* but in legal contemplation constituted an assignment notwithstanding the use of the word 'license.' Respondent maintains here that similarly, the giving by Rainier of the exclusive perpetual rights under the subject contract to petitioner in the designated territory was tantamount to an *assignment of such rights.* In this connection, there would seem to be no question but that an owner of rights may transfer less than the total rights he owns. Surely one who has property rights such as trademarks and brands in use over a large territory, may effectively transfer and assign, as in this case, exclusive perpetual interests therein in designated localities. Technical considerations as to the effect on the title of the owner would seem to be unimport-

ant. The *rights* themselves *constitute property* along with the goodwill of which they are a part. See the *Coca Cola Bottling Company v. The Coca Cola Company* (D. C., Del., 1920), 269 Fed. 796. In that case it was also held that good will was salable property. The Court further held that a secret process or formula of the manufacture of an article is one in which a property right can exist, and that such rights can be sold in whole or in part.

It is unimportant that no bill of sale or documents of title were passed, as no formalities are required for the transfer of such properties. *Woodward v. White Satin Mills Corp.* (C. C. A. 8th, 1930), 42 F. (2d) 987, 989. The transfer may be, and often is, implied. *Canadian Club Beverage Co. v. Canadian Club Corp.* (Sup. Jud. Ct., Mass., 1929), 168 N. E. 106, 268 Mass. 566. * * *"

With arguments such as these, is it not odd for the Commissioner to assert now that The Tax Court did not clearly understand the effect of its decision when it construed the transaction to be a sale? And is it not odd for the Commissioner now to contend vigorously that the notes constituted advance or prepaid royalties, whereas below in the *Seattle* case he as vigorously insisted that they were not royalties of any character "because the exercise of the option definitely terminated all royalties?"

The Tax Court in the *Seattle* case adopted the position thus taken by the Commissioner, and instead of placing its decision upon any narrow and meaningless distinction

between a perpetual license and the beneficial ownership of a name, it squarely held that the perpetual license involved here was equivalent to a transfer of ownership in the name. This is made clear by the Court's own headnote [R. 36 in No. 11,467]:

> "* * * held, (1) the right to use the trade-name in connection with the manufacture and sale of alcoholic malt beverages is property which the owner thereof could license or assign to another; (2) the grant of an exclusive and permanent right in a limited territory was an assignment of such right; (3) the taxpayer acquired a capital asset and the transaction was a sale and not a li*n*cense."

The Court's opinion (particularly from R. 60 to 71 in No. 11,467) clearly shows a determination that the transaction was a sale rather than a mere license. It stated on page 60 that the mere fact that a lump sum payment was involved was not "determinative *whether the transaction was a license or a sale,*" nor was the fact that the parties are called licensor or licensee [R. 64]; rather the nature of the transaction is controlling and we must look to the extent of the rights granted and the finality of the grant. The Court then reviewed the changes in the parties' relationship upon exercise of the option, stating [R. 61]:

> "* * * Thereafter there was no further payment to be made and the forfeiture clause became inoperative. The exclusive right to use the trade-name in the designated territory became perpetual and the

liability of having it revoked by the happening of a subsequent condition no longer existed in a real sense."

The Court continued by saying that the owner of a trade-name

"* * * may assign or transfer a property right thereto by grant in a limited territory. If such grant is exclusive and perpetual its characteristics more resemble a sale than a license, and this is particularly true where all the consideration has been paid. In Goldsmith v. Commissioner, *supra,* Judge L. Hand said 'It does not unduly strain the meaning of a sale to make it include an exclusive license.' * * *" [R. 62.]

The court continued [R. 63]:

"It is true under this agreement that petitioner could not assign the rights granted to it without the consent of Rainier, but we do not regard this provision as controlling here. Neither could Rainier assign the right to another or use it itself. The exclusive grant to petitioner resulted in the retention by Rainier of the naked legal title in the interest granted for the benefit of the grantee. Moreover, by the grant of an exclusive right and the agreement not to compete, Rainier transferred to petitioner its business in alcoholic malt beverages sold under the trade-name in the limited territory."

After quoting from *Parke, Davis & Co.*, 31 B. T. A. 427, that in "*a question of income tax liability* * * *

(the) legal title is of little consequence and the inquiry is as to the ownership of the beneficial interest." The Court concluded as follows [R. 66-67]:

> "* * * It, therefore, makes no difference what terminology is applied to the payment. Regardless of the language used, it was the intention of the parties that upon the payment of $1,000,000 the petitioner should have the exclusive and perpetual use of the trade-name 'Rainier,' regardless of the quantity of beer manufactured and for all future time. *These provisions, we think, are inconsistent with the theory of a lease or license and are more consistent with the idea of a sale.* * * * *All of these facts are consistent with the idea of a sale, but not consistent with the idea of a license.* We see no inhibition where a corporation owns a trade-name to its assigning a right to use that name in a designated territory for a price, and if the right to use is perpetual and exclusive *it is more consistent with the idea of a sale than a lease,* particularly where it is not dissociated from the business or merchandise with which it has been used. * * *" (Emphasis added.)

It will be seen from the foregoing that the Court in the *Seattle* case approached the question as much from the standpoint of the grantor (Rainer) as it did from that of the grantee (Seattle). We respectfully submit that the Commissioner is in error when he alleges that The Tax Court did not specifically hold in the *Seattle* case that there was a sale.

II.

The Tax Court Was Correct in Finding and Deciding That the Transaction Constituted a Sale Rather Than a License.

The Tax Court was thoroughly justified in determining that the contract under consideration, both factually and legally, was in reality a license of the name "Rainer" with an option to purchase at the end of five years.

The Commissioner asserts that a "sale" within the meaning of the Internal Revenue Code means a transaction "which qualifies legally as a 'sale' and is commonly understood to be encompassed by that word." (Br. 57.) We do not know what is meant by the words "qualifies legally," but we do agree that a sale for tax purposes is such a transaction as is commonly understood to be a sale. That appears to be the only criterion laid down by the Supreme Court. *Helvering v. Flaccus Leather Co.*, 313 U. S. 247; *Fairbanks v. United States,* 306 U. S. 436. In *Burnet v. Harmel,* 287 U. S. 103, the Court stressed the fact that an oil and gas lease is not commonly understood to be a sale of the natural resources in place. The practical aspect was emphasized also in *Hale v. Helvering,* App. D. C., 85 F. (2d) 819, cited by the Commissioner, where the decision turned largely upon the ground that neither business men nor lawyers refer to the compromise of a note as a sale to the maker.

There can be no question in the present case but that exercise of the option would be, and in fact was, commonly understood to constitute a sale of the name. Certainly the presidents of both companies so understood it, as did the citizens of Seattle who developed an interest in buying stock of the Seattle Company in reliance upon

the president's announcement in the financial section of the public press that new stock would be issued to finance the "outright purchase" of the name in Washington and Alaska. The transaction would be commonly understood to be a sale by anyone who read the report on either company by the reliable organization Dun and Bradstreet, Inc. Going back to the origin of the agreement, the parties provided that the Seattle plant would stand as security for the performance of *all* the obligations of Seattle under the contract, and at the same time they provided that the security would be released if Seattle should exercise the option and pay the million dollars. This certainly indicated the belief of both parties that such exercise and payment would bring to an end any possibility of a default on the part of Seattle that would justify liquidated damages or termination of the contract.

We submit that as a practical matter the grant of a perpetual license to use a trade name, which cannot be terminated, is equivalent to an assignment of the name. Particularly is this true where, in final analysis, there is no perceptible difference between a trade name as such and the right to use a trade name. This proposition is established by the cases cited on pages 46 and 47 of the Commissioner's brief, which we shall not repeat. The only office of a trade name is to protect the good will which it symbolizes; it cannot be transferred and does not exist separate and apart from a business. Hence, what does the owner have left in the trade name when he has disposed of the business and, for a lump sum of $1,000,000.00, granted the vendee the sole, exclusive, and perpetual license to use the name? Surely there can be no reversion after a perpetuity.

The classic definition of a royalty is a periodic payment to the owner for the use of his property and in proportion to the use made thereof. If, in substance, an owner has only a perpetual right to use a name, what elements of ownership to sustain a royalty are left after he has conveyed to another that perpetual user? To say that he is none the less possessed of a legal title is to make taxes turn upon technicalities of form. The income-producing properties of the asset are gone, which alone gave economic value to it. That is the substance of the matter. In their place are $1,000,000.00. Taxwise, the owner will recover its cost of that asset out of the $1,000,000.00, or not at all.

A persuasive analogy to our unique situation here is the line of authority in the tax field growing out of the grant of easements with respect to real property. Much the same type of a situation is there involved: the land owner retains record title to the land, just as Rainer purported to retain title to the registrations here; neither type of property is subject to depreciation, so the owner cannot look to annual deductions for a recovery of his capital; and the granting of an easement contains the principal factor of perpetual use which is of prime importance here. In *H. L. Scales,* 10 B. T. A. 1024, the petitioner granted to a levee improvement district a perpetual easement and right-of-way for flood control purposes over 324.4 acres of his 6,000 acres of land. The Commissioner determined that the consideration received for the easement was taxable as ordinary income; but the

Board held, on the contrary, that petitioner was entitled to deduct as a capital loss the difference between his cost of the 324.4 acres and the amount received. The Board said:

> "Under the provisions of this instrument it is plain that about the only thing or interest remaining in the petitioner is the bare legal title and that this is of no practical or market value. * * *"

The Board then quoted from many authorities and concluded:

> "In view of these authorities and the facts that the petitioner has surrendered perpetual and complete control of the 324.4 acres involved hereinto the Levee Improvement District, and that it is useless for purposes of cultivation or grazing because almost always overflowed by water, we must hold, for the purposes of this proceeding and for taxation, that the conveyance to the Levee Improvement District was tantamount to a sale and that petitioner has no beneficial interest therein. * * *"

The Bureau of Internal Revenue acquiesced in this decision, C. B. VII-2, 35, and apparently has recognized its justice, for even where some beneficial use of the land has remained in the owner, the Bureau holds that the amount received from the grant of an easement should be applied against and reduce the basis of the land. See G. C. M. 23162, C. B. 1942-1, 106.

Not only as a practical matter has the owner of a trade name sold his interests therein when for a lump sum he has granted a perpetual right to its use, but the courts have generally held that a perpetual license, in

legal contemplation, amounts to a sale or disposition of the property interests in the name.

In *Griggs, Cooper & Co. v. Erie Preserving Co.,* 131 Fed. 359, the agreement granted "the absolute and exclusive use" of a trade-mark *"in and to the several states of Minnesota, Wisconsin, North Dakota, South Dakota and Montana, * * * during such time only as they* [the licensees] *and their successors shall continue in business,"* with certain reservations in favor of the grantor. It was held that this agreement effected a transfer of the trade-mark notwithstanding the geographical limitation, the reservation of rights in the assignor, and the limitation of business by the assignee or its successors. The Court said:

> "* * * The specific language employed is open to the reasonable construction that the intention of the assignor was to convey to Griggs, Cooper & Co., complainant, an absolute and exclusive ownership of the trade-mark 'Home Brand,' and the right to use the same in the sale of its vendible commodity in the localities mentioned in the assignment. The reservation to the transferor does not limit or qualify the alienation of the prior adopted mark to complainant and its successors in their business. * * * The argument of the defendant proceeds upon the theory that Fry & Co., because of the limitations expressed in the assignment, did not convey an exclusive right to appropriate the distinctive mark by which its vendible goods were identified, and that the effect of the writing was to create a mere license which did not convey the good will or business of the transferor, and therefore complainant has no such exclusive right to the use of the words 'Home Brand' or the word 'Home' as would permit recourse on the

part of complainant to a Court of Equity for a violation of trade-mark rights. This proposition is thought unsound. The written agreement unquestionably carried with it a valuable concession which inured to the business advantage of the complainant corporation. On the other hand, the assignor parted with the exclusive ownership and good will in its arbitrarily selected trade-mark 'Home Brand' within the territory specified in the assignment, merely reserving to itself, as we have seen, certain permissive rights in its personal use. The primary acquisition by Fry & Co. of the mark adopted to indicate its manufacture of the articles to which the same was appropriated was undeniably transferable * * * and such assignment is sufficient to entitle complainant to the protection afforded to owners of trade-marks in like cases. * * *"

In *Andrew Jergens Co. v. Woodbury, Inc.*, 273 Fed. 952 (District Court of the District of Delaware), the Woodbury Institute, in consideration of stock of the Woodbury Company, executed a contract in 1905 whereby the Institute—

"* * * shall and hereby does give and grant to the company the exclusive license to use the aforesaid neckless head trade-mark, * * * except in so far as conflicting rights have heretofore been given or granted to other persons or corporations, reserving to itself, however, the right to use the same so long as it shall continue in active business, but not otherwise; * * * and further agrees with the company that, if at any time the Institute shall cease to engage in active business, the right of the Institute to use said lists of patients and said mailing lists shall cease, and the same shall become the exclusive property of the company."

It was contended that the Woodbury Company had acquired no title, but a mere license, under the contract of 1905, but the Court held:

> "The complainant further urges that, if the contract was not void, it constituted but a mere license, personal to the Woodbury Company, to use the mark. I cannot agree with this contention, for I think the agreement discloses a purpose to transfer, and that it did transfer to the Woodbury Company, all rights in the trade-mark, subject only to the two exceptions, and that, although using the word 'license,' it was, in legal contemplation, an assignment. Sirocco Engineering Co. v. Monarch Ventilator Co. (C. C.), 184 Fed. 84; Griggs, Cooper & Co. v. Erie Preserving Co. (C. C.), 131 Fed. 359."

In *Coca-Cola Bottling Co. v. Coca-Cola Co.,* 269 Fed. 796 (1920) (District Court, District of Delaware), the Coca-Cola Co. had adopted the trademark "Coca-Cola" in its business of manufacturing and selling syrup which was used only as a base for drink served at soda fountains. In 1899 it executed a contract looking to the establishment of a bottling business, which contract provided as follows:

> "Said party of the second part further agrees and hereby grants to said parties of the first part, the sole and exclusive right to use the name Coca-Cola and all the trade-marks and designs for labels now owned and controlled by said party of the second part, upon any bottles or other receptacles containing the mixture heretofore described, and the right to vend such preparation or mixture bottled or put up as aforesaid, in all the territory contained in the boundaries of the United States of America, except

the six New England states and the states of Mississippi and Texas. This right to use the name Coca-Cola and the trade-mark and label furnished is to be applied only to the carbonated mixture described, and is not intended to interfere in any way with the business and use of the same as now operated by the party of the second part, nor to apply to the soda fountain business as now operated by various parties. The rights of the parties of the first part under this contract may be by them transferred to a company, the formation of which is now contemplated by them to be known as the Coca-Cola Bottling Company, *but no transfer of their rights under this contract to any other party or parties, shall be made without the consent of the party of the second part."* (Emphasis added.)

It will be seen that this contract embodied three factors analogous to the present case: (1) geographical limitation; (2) the assignee could not assign without the assignor's consent; and (3) the transfer covered only bottled drinks, reserving the name as applied to the syrup. Nevertheless the Court held that there had been a conveyance of good will and property interests in the name. It stated:

"* * * The Georgia corporation * * * granted and conveyed to the bottlers 'the right to use the trade-mark name Coca-Cola, and all labels and designs pertaining thereto, in connection with the product bottled Coca-Cola' in the prescribed territory. The extent of the good will, symbolized by the trade-mark, so transferred, is disclosed by the grant of the 'sole and exclusive' right thus to use the name and trade-mark, or, as expressed in the amend-

ment, by the negative covenants of the Georgia corporation that it will 'only manufacture syrup for bottling purposes in sufficient quantities to meet the requirements' of complainant and others holding similar rights * * *. The good will so transferred was, as to the bottling business, perpetual and exclusive.

The transfer of the interest in the trade-mark was not a transfer in gross. The right to transfer the good will and trade-mark under such circumstances is shown by the authorities hereinbefore referred to. As I see it, it is immaterial whether the interest in the trade-mark acquired by the bottlers was a legal title or merely a beneficial interest. * * * Consequently the ultimate question touching the trade-mark would thus seem to be, not whether the trade-mark could be assigned, but merely the extent of the interest assigned. *If a limited interest therein by way of license could have been assigned, no reason appears why, under the circumstances, an unlimited interest could not likewise have been assigned*"

* * * * * * * *

In *Canadian Club Beverage Co. v. Canadian Club Corp.*, 168 N. E. 106 (Supreme Judicial Court, Mass., 1929), the former owner of the "Canadian Club" trade-mark, William Ireland, Inc., by a written instrument executed in 1922, sold to plaintiff its bottling plant,

"* * * 'together with all labels used in connection with the bottling and tonic business conducted

by said William Ireland, Incorporated, and together with the right to use the "same Canadian Club" for all purposes except in connection with the manufacture of syrups.' "

In 1923 Ireland was declared a bankrupt and all its business was sold to defendant's predecessors, who thereafter attempted to revoke plaintiff's license to use the name Canadian Club. The Court held that the name passed with the sale of the bottling business, saying:

> "* * * The conclusion is warranted that the name was used under a claim of right, *and that the property in the trade name was sold to the plaintiff in February, 1922.* (Emphasis added.)
>
> * * * * * * * *
>
> * * * If the word 'same' preceding the words 'Canadian Club' is an error for the word 'name,' then the right to use the trade name 'Canadian Club' was expressly granted to the plaintiff and Ireland had authority under the vote of the directors to make this assignment. If there was no mistake in using the word 'same,' the name would pass as an asset of the Ireland company and a part of its bottling equipment."

From these authorities we submit that in legal contemplation a grant of the perpetual right to use a name is tantamount to an assignment of the property in the trade name.

III.

Reply to the Commissioner's Argument on Brief.

A. In Part A of his brief (pages 25-30) the Commissioner compares the million dollar payment in this case to the cash bonus received upon the execution of many oil and gas leases.

This comparison overlooks the three reasons why a cash bonus in an oil lease is taxed as ordinary income. The first is that it is treated as ordinary income *only* where the assignor has reserved an economic interest in the oil property, such as a royalty dependant upon production of oil. In other words, the term *advance* royalty presupposes that a regular royalty will follow; otherwise the word "advance" is meaningless. If no such economic interest in the oil property is retained by the assignor, the transaction is treated as a sale and the cash bonus is taxed as proceeds of sale. *Helvering v. Elbe Oil Land Development Co.*, 303 U. S. 372, 82 L. Ed. 904. In the second place an assignor who has retained an economic interest need not look to the sale or exchange provisions of the Code to recover his capital investment tax free; he stands to recover his entire capital—not only representing the interest he has allegedly sold but his retained interest as well—by way of statutory depletion allowances that are deductible not only from future recoveries but from the cash bonus itself. The compelling necessity of recovering capital from a single lump-sum consideration, or not at all, is thus not present where an economic interest is retained. And conversely, if the assignor will derive no future benefit from a retained interest, the transaction *is* treated as a sale and immediate recoupment of capital is available to him as on a sale. The third reason was

stated by the Supreme Court in *Burnet v. Hormel,* 287 U. S. 103—a lease of oil property, with retention of a royalty interest, is not commonly understood to be a sale of the oil in place.

In the present case the taxpayer had an unadjusted basis of half a million dollars in the trade name "Rainier" as used in the sale of beer in Washington and Alaska. It conveyed the entire beneficial interest in that asset to Seattle for one million dollars. It has retained no economic interest whatever in that asset in those areas. To characterize the payment as an "advance" royalty is at odds with the facts. Rainier must recover its basis of the asset out of this payment or not at all. It could not do so from the proceeds of sale of any subsequent transfer of its business, for the purchaser could acquire no rights to the name in Washington and Alaska (since Rainier carries on no business in those areas it could not assign to a subsequent purchaser any business, good will or interest in a trade name in those localities). Finally, as we have seen, the transaction here was commonly understood to be a sale.

B. In this part of his brief (pages 30-37) the Commissioner argues that the *Dobson* rule does not preclude this Court from determining that there was no sale. The first ground is that The Tax Count's finding of a sale is not persuasive because of its failure to understand the effect of the decision in the *Seattle* case. We have answered this contention in Part I of this brief, *supra.* The Commissioner also asserts that in any event "there is no factual basis for The Tax Court's decision." We believe that the factual basis, resting upon uncontradicted evidence as to the intent and common understanding of

the parties, not only adequately supported the Court's finding but practically compelled it to reach the conclusion it did. This matter has also been fully discussed hereinbefore.

The final reason advanced for not applying the *Dobson* rule is that whether a sale occurred or not is a clear-cut question of law. The Commissioner asserts (Br. 35-6):

> "The *Dobson* case itself is authority for the proposition that only a question of law is presented when the question is whether the undisputed facts establish a 'sale of a capital asset' within the meaning of Section 117 * * *."

The Commissioner then quotes nearly the entire opinion of the Supreme Court in denying the petition for rehearing. *Dobson v. Commissioner,* 321 U. S. 231, 88 L. Ed. 691.

Our interpretation of this opinion is exactly the opposite from what the Commissioner finds in it. The taxpayer in that case admittedly had realized income, but claimed it should be taxed as capital gain, as opposed to the Commissioner's treatment of the item as ordinary income. There was absolutely no dispute as to the facts, for they had all been stipulated. *John v. Dobson,* 46 B. T. A. 770. The Board of Tax Appeals disposed of the issue on page 774 as follows:

> "* * * Petitioner's contention that the income so realized should be taxed as capital gain is denied on authority of *Avery R. Schiller,* 43 B. T. A. 594."

The cited case involved similar facts, where the Board had said, "we do not think that the facts in the instant case show that petitioner made a sale of the stock * * *."

Hence, the Board's implied, if not expressed, holding in the *Dobson* case was that capital gain was not involved because the transaction did not constitute a sale. In his petition for rehearing before the Supreme Court the taxpayer argued that the issue below presented questions of law. If the Supreme Court had agreed with that view it certainly would have been necessary to decide whether the transaction, as a matter of law, did or did not constitute a sale. But it did not do that; it merely pointed to the absence of a finding by the Board that a sale occurred (which was tantamount to a finding of fact that the transaction did not constitute a sale, particularly in the light of its reliance on the *Schiller* case) and held that it could not decide as a matter of law that the transaction was a sale or exchange "in the accepted meaning of those terms."

Upon the authority of that case how can it be argued that this Court is in a better position to declare a transaction not to have been a sale as a matter of law where The Tax Court has made an explicit finding of fact that it was? The *Dobson* case, we submit, is to the contrary.

The Tax Court in the present case found as a fact that exercise of the option effected a sale. There was ample evidence to support the finding, for both parties expressly characterized the transaction as a sale and the public so understood it. The *Dobson* case establishes the principle that findings are conclusive if supported by any substantial evidence; and hence the finding in this case is not reviewable by this Court. Although the Commissioner alleges generally that there is no factual basis for The Tax Court's decision (Br. 37), his brief does not even attempt to support the assertion. He admits that there was "some evidence that Seattle's option was regarded

as a right to purchase." (Br. 55.) There not only was "some" evidence, but it was direct, positive and uncontradicted. The Commissioner presented no evidence whatever to the contrary.

The Supreme Court has applied the *Dobson* doctrine in affirming The Tax Court's conclusion as to whether a transaction was or was not a sale. In *Choate v. Commissioner,* 324 U. S. 1, the owners of an oil and gas lease assigned the lease, together with all the equipment thereon, to another party for $110,000.00 cash plus a royalty of one-eighth of all the production therefrom. The Board of Tax Appeals held, in line with many Supreme Court decisions, that the reservation of an economic interest in the oil, through retention of a royalty, reduced the transaction to a sublease insofar as the lease itself was concerned, notwithstanding the agreement designated the parties as "buyers" and "sellers." In other words, the cost of the lease would be recoverable through depletion allowances, including depletion on the cash bonus or advance royalty, rather than recouping the entire cost out of the cash bonus as upon a sale.

The important point here is that the Board further held that the same transaction effected a sale of the equipment on the lease and that the portion of the $110,000.00 attributable to the equipment should be treated as proceeds of sale and reduced by the entire cost basis of the equipment. The Board reasoned, how else could the taxpayer recover the cost of its equipment—bearing in mind that depletion, which would return tax-free the capital invested in the oil itself, could never be claimed with respect to the physical equipment. For the practical purposes of taxation the only reasonable way to recover

the cost of the equipment was to treat the transaction as a sale to that extent.

Incidentally, it should be observed that this case is ample authority for the point we made above, that cases dealing with the retention of economic interests in oil and gas properties represent a unique type of case, for the practical reason that the assignor stands to recover his entire capital investment—with respect to the interest allegedly sold as well as his retained interest—by way of depletion deductions; whereas with other types of property unless a taxpayer can recover his cost out of a lump sum payment, constituting all he will ever receive, he will completely lose his capital for tax purposes forever. It was for this compelling reason that the very same agreement in the *Choate* case was held to result in a sale of equipment while at the same time it was held not to result in a sale of the gas and oil lease.

The Commissioner appealed the conclusion of the Board with respect to the physical equipment to two Circuits. The Fifth Circuit affirmed the Board, *Hogan v. Commissioner,* 141 F. (2d) 92; the Tenth Circuit reversed, with one Judge dissenting, *Choate v. Commissioner,* 141 F. (2d) 641, saying at page 642:

> "In the case at bar the instruments clearly on their face reflect that the transaction was one in entirety covering both the oil reserves and the equipment and that consequently the depletion method must be applied to the entire consideration * * *."

The Supreme Court granted certiorari to resolve this conflict. It pointed out that "The Commissioner makes an elaborate argument based on the assumption that there was no sale of the equipment." It then stated that there

were two difficulties with his argument, the first being that there is no provision in the Code or regulations for depletion of equipment, and—

> "* * * In the second place, The Tax Court found that the parties intended a cash sale of the equipment. That question is argued here as if it were open for redetermination by us. It is not. It is the kind of issue reserved for The Tax Court under Dobson v. Commissioner, 320 U. S. 489, and Wilmington Co. v. Helvering, 316 U. S. 164, 167-168. Once a sale of the equipment is conceded, it is not denied that petitioner is entitled to an allowance for the unrecovered cost of the equipment transferred * * *."

The Commissioner (Br. 34) attempts to distinguish that case by stating that in the present case there is "no factual question here as to the intent of the parties (as in *Choate v. Commissioner,* 324 U. S. 1) * * *." The truth of the matter is that there was no factual question as to the intent of the parties in the *Choate* case—no conflict of evidence. The only finding in that case going to the matter of intent was that "Neither the Choates nor Hogan understood that they had any rights as landlord." Certainly this finding should be no more binding upon an appellate court than the following finding* in the Seattle case [R. 70-1 in No. 11,467):

> "* * * it was obviously the intention of the parties that Rainier grant to petitioner all of the right which

---

*See *American Box Shook Exp. Ass'n. v. Commissioner,* C. C. A. 9, 156 F. (2d) 629, 631, where this Court cited its previous decisions to the effect that "we may read the findings of the Tax Court together with its opinion to ascertain what the Tax Court found as facts."

it had to use the trade-names 'Rainier' and 'Tacoma' in the manufacture and sale of alcoholic malt beverages in the State of Washington and the Territory of Alaska. It was also the intention of the parties that this grant was to be exclusive not only as to third parties but as to Rainier itself. We know of no reason why one who is the owner of the right to use a trade-name may not grant to another its exclusive use in a limited territory for all future time upon the payment of a price. * * * Such a grant, while not disposing of the entire property in the grantor, is the equivalent of such disposition within the limited territory granted. * * *"

Also dealing with the intention [R. 66]:

"* * * Regardless of the language used, it was the intention of the parties that upon the payment of $1,000,000.00 the petitioner should have the exclusive and perpetual use of the trade-name 'Rainier,' regardless of the quantity of beer manufactured and for all future time. These provisions, we think, are inconsistent with the theory of a lease or license and are more consistent with the idea of a sale. * * *"

In view of the foregoing it is respectfully submitted that The Tax Court's findings and conclusions in this case are correct, and in any event the *Dobson* rule precludes reversal here.

C. On pages 37 to 45 of his brief the Commissioner asserts that Seattle acquired only a limited right to use the trade name. The limitations stressed by the Commissioner are that (1) the contract covered only Washington and Alaska, (2) it applied only to beer, ale and other alcoholic malt beverages, (3) Seattle could not assign without

Rainier's conset, and (4) Rainier agreed to maintain the registrations.

We have seen above that trade names exist only in connection with a business; and since businesses can be split up and sold in geographical units the same is true of goodwill and trade names. This necessarily follows from such cases as *United Drug Co. v. Rectanus Co.*, 248 U. S. 90, 63 L. Ed. 141, where it was held that the owner of the trade-mark "Rex," which had been used only in the New England States in the sale of certain medicine, could not thereafter enjoin the defendant from using the same mark in the sale of similar medicine in Kentucky, when the adoption and use of the name by the latter was without knowledge of the former's rights in the other location. The necessary result of such a decision is that each owns the name in his own territory. To the same effect is *Hanover Star Milling Co. v. Metcalf,* 240 U. S. 403, 63 L. Ed. 713; and in *Esso, Inc., v. Standard Oil Co.* (C. C. A. 8, 1938), 98 F. (2d) 1, 7, it was held that two companies, each a former subsidiary of Standard Oil Company of New Jersey, were entitled to the exclusive use in their respective territories of the same trade marks.

If by adoption and use the same name on the same type of product can thus be owned by two different individuals, operating in different markets, what reason could there possibly be for holding that if one merchant owns a trade-name in an extensive area he cannot convey to another a part of his business, including the goodwill and name, in a portion of that area? We submit that there is none, and have been unable to find any authority to support such a curious result.

On his second point, that Rainier reserved the right to use the name in the sale of nonalcoholic beverages, the Commissioner is foreclosed by the case of *American Crayon Co. v. Prang Co.* (C. C. A. 3, 1930), 38 F. (2d) 448, vacating 28 F. (2d) 515, where the Prang-Maine Company, selling 70 or 80 articles under the name "Prang," sold to the American Company its right, title and interest in and to the trade-name "Prang" as applied to six specific products, viz., crayons, pastels, oil and water color paints, pencils, erasers and pens. In a suit by the American Company against Prang-Maine for infringement, the Court held that its rights had been infringed, saying:

> "* * * we are of opinion that so far as the specified articles * * * are concerned, the Prang-Maine gave up everything of a Prang name, character or mark to the American. * * *" (At p. 449.)

In the course of its opinion the Court refers specifically to the "sale to American" and to the fact that paste "was not included in the sale."

Similarly, our case is the same in this aspect as *Coca-Cola Bottling Co. v. Coca-Cola Co., supra,* and *Canadian Club Beverage Co. v. Canadian Club Corp.* (S. C. Mass., 1929), 168 N. E. 106, in each of which a transfer was made of a trade name for use only in connection with bottled drinks, the vendor in each instance expressly reserving the use of the name in the sale of syrups. Notwithstanding this limitation the Court in the latter case declared that "the property in the trade name was sold" insofar as it related to the bottling business. *A fortiori,* we submit, it was competent as a matter of law for Rainier to sell its name as applied to alcoholic malt beverages, retaining the right for what it might be worth

at some indefinite time in the future to use it on nonalcoholic beverages. This reservation causes no difficulty insofar as the basis is concerned, for at March 1, 1913, the predecessor was not manufacturing nonalcoholic beverages and never had. Hence, all the value—and therefore the basis—attached to the use of the name upon the sale of beer.

Insofar as the provision against assignment by Seattle without Rainier's consent is concerned, this case is no different from *Coca-Cola Bottling Co. v. Coca-Cola Co.*, 269 Fed. 796 (D. C., Del.), discussed above. It is also similar to *Parke, Davis & Co.*, 31 B. T. A. 427, which was relied upon by The Tax Court [R. 63-64 in No. 11,467]. The taxpayer in that case granted a license for a lump sum, the "licensee" agreeing not to assign without consent of the "licensor." The taxpayer contended that the consideration was a return of capital, inasmuch as a one-half interest in the patents had been transferred by the contract. The Commissioner contended as here that the sum was ordinary income, predicated upon substantially the same grounds as he urges here, including the fact that the licensee "did not receive the right to grant to others, by way of license, the right it received from petitioner."

The Board of Tax Appeals held that the transaction constituted a sale. In an opinion reviewed by the full Board it stated:

> "* * * It is true that a right to sell the invention or to grant to others a license was not transferred to Lilly, but petitioner by the agreement surrendered the right to exercise these privileges without Lilly's consent, so that its rights in this respect were no greater than those of the latter. * * *"

The board then emphasized the accepted principle that bare legal title is not of supreme importance in tax litigation. It declared:

> "* * * The right to maintain a suit at law is often controlled by the question of the possession of the naked legal title. Here we have a question of income tax liability where legal title is of little consequence and the inquiry is as to the ownership of the beneficial interest. We are not to determine whether petitioner or Eli Lilly & Co. could maintain a suit for infringement in its own name, but merely whether petitioner, under its contract with Eli Lilly & Co., divested itself irrevocably of certain capital investments in consideration of the payment made to it by the latter company. If this is the fact, then the transaction for income tax purposes is no more than a conversion of capital."

Similarly here, Rainier now cannot transfer or assign any interest in the name in Washington and Alaska, since it now carries on no business there.

The foregoing also answers the point about Rainier's maintaining the registrations. Naked legal title is of no significance in the practical field of taxation. Furthermore, it is well settled that registrations are purely procedural in nature and do not alter or impair substantive common law rights as regards the ownership of trade names. See *United Drug Co. v. Rectanus Co.,* 248 U. S. 90, 98, 63 L. Ed. 141, 146; *Armstrong Paint & Varnish Works v. Nu-Enamel Corp.,* 305 U. S. 315, 333, 83 L. Ed. 195, 206; *Est. of P. D. Beckwith v. Comm. of Patents,* 252 U. S. 538, 543, 64 L. Ed. 705, 707; *Pennsylvania Petroleum Co. v. Pennzoil Co.,* C. C. P. A., 80 F. (2d) 67;

Motlow v. Oldetyme Distillers, Inc., C. C. P. A., 88 F. (2d) 732, and *Ph. Schneider Brewing Co. v. Century Distilling Co.,* C. C. P. A., 107 F. (2d) 699, 703.

D. This section of the Commissioner's brief (pages 46-51) establishes the admitted proposition that a trade name cannot be assigned in gross, dissociated from the business to which it is appurtenant. But clearly there is no merit in his application of that principal to the facts of this case; that Rainier sold its business only in Alaska and Washington and had not manufactured its products in those areas do not militate against the plain fact that the business it had carried on in Washington and Alaska was conveyed to Seattle. So far as we are advised there is no requirement that the business must be that of manufacturing to permit a valid assignment of a trade name. And the sale of a business limited to certain states is a common occurrence, sanctioned by many of the cases heretofore cited.

Yost v. Commissioner, 9 Cir., 155 F. (2d) 121, cited by the Commissioner, is not in point here, because a stockholder obviously has sold nothing when he receives a consideration merely for voting his stock in a certain manner (to permit sale of the corporate assets and the execution of a covenant by the corporation not to compete with the purchaser). The corporation in that case, however, had clearly made a sale; and all that is claimed here is that Rainier, not its stockholders, made a sale. The Court stated in the *Yost* case that the stock which the holder continued to own had a substantial value and there was a very practical reason for not liquidating the stock, *i. e.*, contemplated resumption of business by the corporation.

Hale v. Helvering, App. D. C., 85 F. (2d) 819, held that the maker of a note does not sell anything when he pays the note in full or partially in compromise; and certainly it would be strange to regard such a payment of a debt as a sale by the debtor. The Court said that insofar as the debtor was concerned the property in the note was merely extinguished. The Commissioner presents a curious analogy by alleging that the property of Rainier represented by the name "Rainier" was partially extinguished when the option was exercised. We cannot see how it was extinguished, for the Seattle Company has it and has used it ever since. The name in Washington and Alaska did not cease to exist as property as does a note in the hands of its maker.

E. In this phase of his brief (pp. 51-61) the Commissioner attempts to distinguish the trade-mark cases relied upon by The Tax Court, which we have presented in considerable detail in Part II of this brief, *supra*. The Commissioner asserts that the Court in *Griggs, Cooper & Co. v. Erie Preserving Co.*, W. D. N. Y., 131 Fed. 359, "did not state that there had been a sale of the trade-marks." We quote from the Court's opinion:

> "* * * The specific language employed is open to the reasonable construction that the intention of the assignor was to convey to Griggs, Cooper & Co., complainant, an absolute and exclusive ownership of the trade-mark 'Home Brand,' and the right to use the same in the sale of its vendible commodity in the localities mentioned in the assignment. * * *"

The Commissioner states that the only real question in *Coca-Cola Bottling Co. v. Coca-Cola Co.*, D. C. Del., 269 Fed. 796, was whether the contract was terminable at will;

but the *reason* for the Court's negative answer to that question was because of its determination that the contract had effected a transfer of good will and the trade name for use on bottled drinks—a transfer that was "unlimited," to use the Court's own term, perpetual and exclusive in the territory covered by the agreement.

The Commissioner recognizes that title had passed in *Andrew Jergens Co. v. Woodbury, Inc.*, D. C. Del., 273 Fed. 952, aff'd 3 Cir., 279 Fed. 1016, certiorari denied, 260 U. S. 728, subject, however, to divestment "by the happening of a condition subsequent—the discontinuance of active business by the assignee." The significant point here is that this condition subsequent plainly prohibited the assignee from transferring its rights; yet this prohibition was not deemed to preclude the conclusion that there had been a transfer of the property in the name.

We respectfully submit that the cases cited by The Tax Court fully support its decision.

The Commissioner alleges generally that decisions involving copyrights are also pertinent and he cites several of them on page 60. Such an argument loses sight of the fundamental difference between a copyright and a trade name and of the reasons which led the courts to hold as they have with reference to copyrights. As the Supreme Court stated in *Delaware and Hudson Canal Co. v. Clark*, 13 Wall. 311, 20 L. Ed. 581, 583:

> "* * * Property in a trademark, or rather in the use of a trademark or a name, has very little analogy to that which exists in copyrights or in patents for inventions. * * *"

While the right in a trade-name consists only of its user, the Board of Tax Appeals stated in *E. Phillips Oppenheim*, 31 B. T. A. 563, 565:

> "* * * A copyright—'the exclusive privilege of printing * * * publishing and vending copies of a literary * * * production'—embraces a number of privileges the use of which may be separately licensed in order to realize the fullest value of the work. * * *"

See I. T. 2735, XII-2 C. B. 131, 134, where it was stated:

> "In 'An Outline of Copyright Law' by Richard C. De Wolf (pages 77-78) it is stated:
>
> Through a series of licenses the various rights included in a single copyright may be parceled out among a number of different licensees, and this is a means of realizing the fullest value of a copyrighted work. In the case of a book, for example, the following series of rights may be the subject of separate disposition by license: Rights of first, and of second, serial publication; book publication; translation; dramatization, and the making of moving pictures. * * *
>
> In 13 *Corpus Juris* (1094-1095) it is stated that a copyright is an indivisible thing and can not be split up and partially assigned, either as to time, place, or particular rights or privileges, less than the sum of all the rights comprehended in the copyright; that exclusive rights may, however, be granted, limited as to time, place, or extent of privileges which the grantee may enjoy; and that the better view is that such limited grants operate merely as licenses and not as technical assignments, although often spoken of as as-

signments. (*New Fiction Publishing Co. v. Star Co.*, 220 Fed. 994; *Goldwyn Pictures Corporation v. Howell Sales Co.*, 282 Fed. 9.)"

This principle has no proper application here, for there are no such separate and distinct rights connected with a trade name. The only right is that of its use in connection with the business to which it is appurtenant. By granting an exclusive license to use a trade name in a given locality the grantor has not split up his interests except geographically, which is treated as an assignment in trade name cases. In the licensed territory he has disposed of all the rights the trade name afforded him.

Hence, the cases dealing with copyrights are based upon the substantive rule of copyright law that a license to use one of the separable rights in a copyright does not constitute a sale or assignment of the copyright itself; whereas, the cases heretofore noted treat an exclusive license to use a trade name in a given territory as a sale of the property in the name. And even in the copyright field the old theory is beginning to break down, for, as the Commissioner recognizes (Br. 69-70), Judges Learned Hand and Swan expressed the opinion that "It does not unduly strain the meaning of 'sale' to make it include an exclusive license."

> *Goldsmith v. Commissioner*, 2 Cir., 143 F. (2d) 466 (certiorari denied, 323 U. S. 774).

F. The last section of the Commissioner's brief on this issue (pages 62-70) is devoted primarily to a discussion of patent cases.

The Tax Court cited a few patent cases as illustrations of the point that a sale of property may be deemed to have taken place for tax purposes notwithstanding the presence

of restrictions against alienation or conditions subsequent which might operate to defeat the transaction. Since the Commissioner apparently does not seriously dispute The Tax Court's holding that the agreement is no longer forfeitable by reason of the occurrence of a condition subsequent, we regard this question as of no importance here. (Br. 41.)

The Commissioner, however, goes into detail with respect to the various types of transfers of interests under a patent for the purpose of showing that the present transfer of trade name rights would not qualify as a sale if tested by such patent criteria.

The difficulty with this argument is that patent law is a statutory subject and the types of transfers that may be made, and their effect, are matters strictly governed by the statute. This is shown by the quotation from *Waterman v. Mackenzie,* 138 U. S. 252, 255, on page 63 of the Commissioner's brief. Furthermore, in that field the words "make, use and vend" have practically acquired the status of words of art, and certainly find no counterpart in the law of trade-marks and trade names.

There is no comparable legislation governing the effect of assignments of trade names. The Trade-Mark Acts passed by Congress do not alter substantive rights in or to trade-marks, but simply provide procedural remedies to protect rights otherwise acquired. See the cases cited in Part III-C of this brief, *supra,* dealing with registration of trade names. A typical statement of the law in this

respect is found in *Ph. Schneider Brewing Co. v. Century Distilling Co.,* 10 Cir., 107 F. (2d) 699, 703:

> "The United States statutes, * * * providing for the registration of trade-marks and the assignment of registered trade-marks neither confer nor limit substantive rights. They merely confer certain procedural advantages to the registrant. The substantive rights are determined wholly by common-law principles. Registration does not create a trade-mark; neither is it essential to its validity. * * *"

Hence, it is respectfully submitted that tests, established in the strict statutory field dealing with patents, may not be adapted to the informal, common-law field of trade names. The significance of the patent cases cited by The Tax Court lies in the fact that with all the restrictions and limitations upon assignments in that field, The Tax Court can still enunciate a wholesome, practical decision for taxation, such as *Parke, Davis & Co.,* 31 B. T. A. 427. In that case, notwithstanding the use of the words "Licensor" and "Licensee," notwithstanding the prohibition against assignment by the "Licensee," and notwithstanding the express retention of the legal title in the "Licensor," the Court concluded that the nature of the grant was a transfer of beneficial ownership with retention of bare legal title solely for the benefit of another. The transaction was taxed as a sale.

In view of all the foregoing we respectfully submit that The Tax Court's findings and decision on this issue should be affirmed.

Second Issue.

On the second issue there is no dispute between the parties over the pertinent legal principles. Rainier recognizes that the basis of property must be reduced under Section 113(b)(1)(B) by the amount of "exhaustion, wear and tear, obsolescence, amortization, and depletion, *to the extent allowed (but not less than the amount allowable)* * * *."

The Supreme Court held that obsolescence of good will was not allowable as a result of the adoption of national prohibition on January 16, 1920. *Clarke v. Haberle Crystal Springs Brewing Company,* 280 U. S. 384, 74 L. Ed. 498. Hence, the sole issue here is over the amount of obsolescence that was erroneously allowed to Rainier. The evidence bearing upon this issue was submitted in the form of a stipulation consisting of five short paragraphs [see Stipulation III, R. 117-118], to which was attached as Exhibit 1 a claim for abatement of taxes for the year 1919. [R. 119-120.] The claim had attached to it Schedules A to F, inclusive [R. 121-127], the significant schedules for present purposes being Schedules E and F, appearing on pages 126 and 127 of the printed record.

It would appear that the Commissioner has *assumed* the two vital facts on this issue. Thus, in his statement of the question (Br. 2), statements of points to be used (Br. 21), summary of argument (Br. 24), and argument on this point (Br. 71-76), the Commissioner *assumes* that Rainier claimed a deduction for obsolescence for the year 1919 *in the sum of $542,240.27* and that the Commissioner *allowed* obsolescence in the sum of $406,680.20.

Neither assumption is supported by the facts in the record, by The Tax Court's findings [R. 60], or by the

Commissioner's statement of the case with respect to this issue. (Br. 19-20.) Indeed, in two sections of his brief (Br. 24, 73) the Commissioner uses the phrase—Rainier *must be deemed* to have claimed and to have been allowed the amount of obsolescence referred to by him. If the evidence clearly showed that Rainier did in fact claim such obsolescence or that it had in fact been allowed, there would have been no necessity for the Commissioner to assert that the facts "must be deemed" to be as he alleges.

The only amount ever actually claimed by Rainier as a deduction for obsolescence was $174,188.84 for the year 1919. [R. 127.] It is true that the claim for abatement of 1919 taxes alleged that the value of Rainier's good will at March 1, 1913, was $542,240.27. [R. 126.] *But this amount was not claimed as a deduction.*

The 1918 return had shown no net income—in fact, a loss of $11,668.17. [Ex. O, R. 892.] No obsolescence was deducted thereon. The 1919 return, which likewise claimed no obsolescence, disclosed net income in the sum of $174,188.84. Shortly after filing that return the claim for abatement was filed (July, 1920).

The claim for abatement expressly stated that no deduction for obsolescence was claimed for the year 1918. [R. 126.] A deduction for 1919 was claimed in an amount sufficient only to offset the income for that year—$174,-188.84. [R. 127.] The "remaining balance of Good Will loss" was expressly stated in the claim to be applicable to "future income" and was not sought as a deduction. [R. 126-127.]

Four years later, in 1924, the Commissioner acted upon this claim for abatement of 1919 taxes, by reducing the value of good will from $542,240.27 to $406,680.20, and

determined that Rainier's claimed deduction of $174,188.24 for the year 1919 would be allowed only to the extent of $59,153.48 and the balance of the claimed deduction ($115,035.36) would be disallowed as a deduction for that year. [R. 117-118.] He then "allocated" the minor sum of $2,464.77 to the year 1920—a net loss year for which no deduction for obsolescence had been claimed. [R. 118.]

The balance ($345,061.95) of the good will as determined by him, representing the $115,035.36 which he had disallowed for 1919 and the portion which the taxpayer had alleged generally to be applicable to future income, was "allocated" by the Commissioner to the year 1918—the year in which the taxpayer's return already showed a net loss of $11,668.17, as we have heretofore stated.* We have placed the word "allocated" in quotation marks because that is the precise word used in the stipulation [R. 118] and in The Tax Court's findings of fact. [R. 60.]

Based upon the above facts The Tax Court was obviously correct in concluding in effect that the only obsolescence actually claimed by the taxpayer was for the year 1919 and in the sum of $174,188.84; and that an amount was not "allowed" where it had never been claimed by the

---

*The Commissioner also revised Rainier's 1918 return so that it showed net income of $78,983.92 instead of a net loss of $11,-668.17. Whether or not at the late date in 1924 the statute would have barred collection of a deficiency based upon net income of $78,983.92 for the year 1918 is not shown in the record; presumably it would have, although for the purposes of this action the taxpayer conceded that a tax benefit of $78,983.92 was realized from the Commissioner's "allocation."

taxpayer but had merely been assigned or "allocated" by the unilateral action of the Commissioner to any year that happened to suit his preference. The Tax Court declared [R. 72]:

> "* * * In other words, a deduction 'allowed,' but not claimed or actually taken, can hardly be said to be 'allowed' where there was no basis in the statute for such an allowance. * * *"

The fallacy in the Commissioner's argument is clearly reflected in his summary of argument (Br. 24):

> "* * * Since Rainier sought a refund of taxes for 1919 based on a claim for a deduction for obsolescence *in an amount greater than the amount of $406,-680.20* allowed by the Commissioner and allocated by him to the years 1918 through 1920 pursuant to such claim, and since Rainier received tax benefits therefrom for both 1918 and 1919, Rainier must be deemed to have claimed obsolescence in the amount of $406,-680.20. That amount was therefore 'allowed' * * *." (Emphasis added.)

The inaccuracies in the above statement are obvious. (1) The taxpayer did not claim a deduction greater than $406.680.20 in seeking a refund of 1919 taxes (its claimed deduction was only $174,188.84); (2) the Commissioner did not "allow" the sum of $406,680.20, for that was the very question at issue and The Tax Court concluded otherwise; (3) the Commissioner allocated the amount of $406,680.20 to the years 1918 through 1920, but certainly he did not do so "pursuant to such claim." He did so in

direct repudiation of the claim, which explicitly stated that no part was applicable to the year 1918.*

The case primarily relied upon by the Commissioner, *Virginian Hotel Co. v. Helvering,* 319 U. S. 523, 87 L. Ed. 1561, was different—in fact, just the reverse of the present situation. The taxpayer in that case had deducted on its returns depreciation of carpets and other equipment, using estimated economic useful lives of 6⅔ and 10 years, respectively. These deductions were not challenged by the Commissioner until 1938, when for that year and future years he determined that the useful lives of the properties were longer, to-wit, 12½ and 20 years, respectively. The taxpayer agreed to the revised estimate of economic useful lives; but it argued that in determining the depreciable sum remaining at the beginning of 1938 (to which the new rates should be applied) the excessive deductions in prior years had not been "allowed" unless they had offset taxable income. The Supreme Court merely held that under the American system of self-assessment all deductions claimed on income tax returns are allowed within the meaning of the statute unless they are challeged by the Commissioner. "* * * Apart from contested cases, that is indeed the only way in which deductions are 'allowed.' * * *"

It is difficult to understand how that case can justify a similar conclusion where the basic fact is that the amount in question had never been claimed as a deduction by the taxpayer.

---

*It may be noted that there was no practical way for the taxpayer to complain of the Commissioner's action, for it was soon determined by this Court and others that no obsolescence whatever was allowable. See *Landsberger v. McLaughlin,* 9 Cir. 26 F. (2d) 77; *Red Wing Malting Co. v. Willcuts,* 8 Cir. 15 F. (2d) 626, cert. den. 273 U. S. 763.

Other cases cited by the Commissioner are entirely consistent with the position of Rainier. Rainier certainly does not dispute the principle that depreciation may be "allowed" although not legally "allowable"—a proposition for which the Commissioner cites *Belknap v. United States* (W. D. Ky.), 55 F. Supp. 90. That case illustrates the principle but did not decide it, for the taxpayer there conceded that the cost basis of property sold in 1938 should be reduced by depreciation erroneously *deducted on his returns for 1930 and 1931* and allowed by the Commissioner without challenge. The issue in that case was whether the Commissioner was correct in determining that depreciation was "allowable" for years after 1931 and therefore should serve to further reduce the cost basis even though the taxpayer had claimed no depreciation for such years. This issue was resolved against the Commissioner on the ground that the property in question was not of a depreciable character and hence there should be no reduction in basis for years subsequent to 1931, because depreciation was neither allowable nor had it been claimed and allowed.

This case is similar to the present case in that obsolescence of good will was not "allowable," and Rainier concedes, as did the taxpayer in the *Belknap* case, that its basis must be reduced by the obsolescence erroneously allowed. But Rainier contends, in line with the actual holding in the *Virginian Hotel Co.* case, that obsolescence is not allowed unless the taxpayer claims it for a specific year and the Commissioner allows the claimed deduction to stand without challenge. The only obsolescence ever claimed by Rainier was the sum of $174,188.84, which, as we have seen, was partially disallowed by the Commissioner. The amount of $406,680.20 referred to by the

Commissioner was his determination of the value of Rainier's good will, but that amount certainly was never allowed by him pursuant to a deduction claimed by Rainier.

Old Colony Trust Co. v. White (D. Mass.), 34 F. (2d) 448, also cited by the Commissioner, dealt with the converse of the above situation, and simply held, which no one is disposed to question, that "allowable" depreciation reduces the basis of property even though none is actually claimed or allowed.* That case has no relevancy here. Similarly, in *Hall v. United States* (Ct. Cls.), 43 F. Supp. 130, certiorari denied, 316 U. S. 664, it was held that the 1913 value of two leaseholds must be reduced by "allowable" depreciation, notwithstanding the Commissioner had not permitted any deduction for depreciation either to the trustee or the income beneficiaries. Implicit in the Court's opinion is the fact that depreciation was "allowable"; and the principal discussion in the case is whether the taxpayer (an income beneficiary) could recoup against the taxes assessed on the gain from the sale of the property the excessive taxes she had paid in prior years as a result of the Commissioner's error in denying her pepreciation deductions in those years.

---

*The case dealt with the hardship situation where depreciable property was held in trust and the entire income was paid to a life beneficiary—a situation that was alleviated by the 1928 Revenue Act and all subsequent Acts by providing that the depreciation should be apportioned among the trustee and income beneficiaries on the basis of the income allocable to each, unless otherwise directed by the trust instrument. See Section 23(1) of the Internal Revenue Code. Before 1928, including 1921, the year involved in the *Old Colony Trust Co.* case, the depreciation was "allowable" only to the trustee; but there was no question but that it *was* allowable to the trustee. See Report of Conference Committee accompanying the Revenue Act of 1928, House Report 1882, 70th Congress, 1st Session, pages 11-12.

Since we are dealing in the present case with obsolescence that was not "allowable" it is difficult to see the applicability of cases which hold only that "allowable" depreciation must be subtracted from the basis of property, whether "allowed" or not. As heretofore stated, Rainier does not dispute the principle for which those cases stand.

The other two cases cited by the Commissioner on this issue are equally inapposite. *Helvering v. Owens,* 305 U. S. 468, 83 L. Ed. 292, was concerned with "casualty losses" flowing from the destruction of or damage to non-business property that is held solely for pleasure or personal uses. Although such property is depreciable in character, depreciation may not be claimed on a tax return because it is not used in business or held for the production of income; nor need depreciation be taken into account in computing gain from its sale, since depreciation is neither allowed nor allowable. But the tax laws, inconsistently perhaps, allow a deduction for the loss of such property *by casualty;* and the *Owens* case limited the amount of the deduction for casualty loss to the fair market value of the property immediately before the casualty. This was only reasonable, for the code allows a deduction for losses only to the extent sustained in the taxable year; and obviously a casualty loss would represent a loss suffered in that year only to the extent of the then value of the property. The decrease in value representing depreciation sustained in prior years could not be carried forward and deducted under the guise of an increased casualty loss; and this would be true even though deductions for the prior depreciation actually sustained were not allowable or allowed for tax purposes due to the personal or pleasurable nature of the property.

The other case, *Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 75 L. Ed. 1049, merely held that the allowable deduction for depletion in 1918 could not exceed the amount of depletion which the parties agreed had actually been sustained during that year; that such deduction could not be increased by taking into account the excess of depletion sustained in prior years over the depletion allowed and allowable during those prior years; but that, upon authority of *United States v. Ludey*, 273 U. S. 295, 71 L. Ed. 1054, 1059, such excess would not be deducted from the basis in computing gain upon a subsequent sale of the property.

We fail to see the materiality of these cases or how they can afford the Commissioner support in his contention that more obsolescence was "allowed" to Rainier than The Tax Court found.

In the final analysis, aside from the obvious correctness of The Tax Court's conclusion, the present situation is an ideal one for application of the *Dobson* rule, for there is no dispute between the parties in respect of the controlling legal principles and the evidence clearly warranted—indeed it required—The Tax Court's conclusions that only $174,-188.84 of obsolescence had been claimed, and not even that amount had been allowed by the Commissioner.

The *Dobson* case itself involved a question under Section 113(b)(1)(A) of the code, and the Supreme Court made the following statement, which is equally applicable to the present question under Section 113(b)(1)(B):

> "* * * What, in the circumstances of this case, was a proper adjustment of the basis was thus purely an accounting problem and therefore a question of fact for the Tax Court to determine. Evidently the

Tax Court thought that the previous deduction were not altogether 'properly chargeable to capital account' and that to treat them as an entire recoupment of the value of taxpayer's stock would not have been a 'proper adjustment.' We think there was substantial evidence to support such a conclusion."

The Commissioner has been able to point to no evidence or principle of law establishing error on the part of The Tax Court in the present case. Its findings and decision on this issue should therefore be affirmed.

Conclusion.

The decision of The Tax Court should be affirmed.

Respectfully submitted,

A. Calder Mackay,
Arthur McGregor,
Howard W. Reynolds,
Adam Y. Bennion,
Attorneys for Respondent.

Of Counsel:
F. Sanford Smith,
Clifford J. MacMillan.